Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
The Commission's Cable Horizontal and Vertical Ownership Limits	)	MM Docket No. 92-264
	)	

COMMENTS OF
NATIONAL CABLE & TELECOMMUNICATIONS ASSOCIATION

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The National Cable & Telecommunications Association (NCTA) hereby submits its comments on the Second Further Notice of Proposed Rulemaking in the above-captioned proceeding.

NCTA is the principal trade association representing the cable television industry in the United States. Its members include cable operators serving more than 90% of the nation's cable television subscribers, as well as more than 200 cable programming networks and services. NCTA's members also include suppliers of equipment and services to the cable industry.

INTRODUCTION AND SUMMARY

The Second Further Notice reflects the difficult task that the Commission faces in attempting to implement the ownership provisions of the Cable Television Consumer Protection and Competition Act of 1992. Congress has directed the Commission to adopt "reasonable limits" on the number of households that a single cable operator may reach and on the number of channels on a cable system that may be occupied by program networks that are owned by cable operators. The United States Court of Appeals for the District of Columbia Circuit has held, however, that, to pass muster under the First Amendment, any such limits must be demonstrably tailored to alleviate the concerns that Congress meant to address in adopting the statutory provisions: "[T]he FCC must show a record that validates the *regulations*, not just the abstract statutory authority," and it must do so on the basis of evidence "'that the recited harms are real, not merely conjectural.'"[1]

The Commission not only compiled an extensive record from commenting parties but also commissioned and conducted its own econometric studies. It discovered, however, that the record was insufficient to justify any particular ownership caps under the court's standard. This is not a problem that further comments and updating of the record is likely to solve.

The Commission has recognized the inherently speculative and conjectural nature of its task. Congress has directed it to determine the point at which "cable horizontal reach will unfairly impede flow of programming, a somewhat fluid concept susceptible to a variety of interpretations."[2] Moreover, the potential for harm arises, if at all, only at some greater level of concentration than exists today – since the Commission has already scrutinized and approved most of the recent mergers and acquisitions, and the pending acquisition of Adelphia by Comcast and Time Warner Cable would leave the acquirers at a level below that struck down by the District of Columbia Circuit. As the Commission notes, "our task in this proceeding is complicated by the possibility that the harms our rules are designed to prevent may arise at concentration levels higher than those that exist in today's markets" and "it has been difficult to ascertain how *hypothetical* market conditions might affect competition and diversity."[3]

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1 *Time Warner Entertainment Co. v. FCC*, 240 F.3d 1126, 1130 (D.C. Cir. 2001) ("Time Warner II"), quoting *Turner Broadcasting System, Inc. v. FCC*, 512 U.S. 622, 664 (1994).

2 Second Further Notice of Proposed Rulemaking ("Second Further Notice"), ¶ 15.

3 *Id.* (emphasis added).

But the problem goes beyond the imprecise and speculative nature of the harm. As NCTA showed in its comments on the First Further Notice – which we incorporate by reference in these comments – changes in the marketplace make the unfair and anticompetitive harm that worried Congress in 1992 unlikely to occur at *any* foreseeable level of horizontal or vertical ownership. Congress was concerned that horizontal concentration, combined with increasing vertical integration, could result in the unfair and anticompetitive suppression of diversity and availability of programming for consumers.[4] But by January 2002, when we filed comments on the First Further Notice, the factual underpinnings of those concerns had been substantially eroded – and they have eroded further over the intervening years.

If commenting parties provide evidence that suggests that there is, in fact, a level of horizontal ownership – or of channel occupancy by cable operator-owned program networks – that threatens the competitive flow of programming to consumers, NCTA will address such evidence in its reply comments.[5] In the absence of any such evidence, however, the court's decision clearly mandates that the First Amendment takes priority over the statutory directive to adopt generally applicable horizontal and channel occupancy limits.

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4 *See, e.g.*, Report of the Senate Committee on Commerce, Science, and Transportation, S. Rep. No. 102-92, 102d Cong., 1st Sess. 32-33 (1991) ("Senate Report"). *See also Time Warner II*, 240 F.3d at 1136, 1137, noting that Congress was mainly interested in preventing "anticompetitive" behavior, that the statutory language "addresses only 'unfair[]' impediments to the flow of programming," and that "it is clear from the structure of the statute that Congress's primary concern in authorizing ownership limits is 'fair' competition."

5 We note at the outset, however, that no such "evidence" is supplied by the many Internet-spawned e-mails that have recently been submitted to the record. Although some parties would like to blur the distinctions between the media ownership rulemakings that caused such controversy over the past several years and the cable rules that are the focus of this docket, the differences are far greater than the similarities. For starters: (1) different statutory provisions are involved; (2) different judicial guidance has been provided; (3) cable ownership rules, unlike broadcast ownership rules, have nothing to do with local concentration; the number of owners of distribution "platforms" in any given market cannot change as a result of this proceeding; and (4) the cable rulemaking does not involve exclusive broadcast licenses or concomitant issues of the public interest responsibilities that attach to use of broadcast licenses.

I. VERTICAL INTEGRATION OF CABLE OPERATORS AND PROGRAM NETWORKS HAS SUBSTANTIALLY DIMINISHED AND POSES NO THREAT TO THE COMPETITIVE AVAILABILITY OF PROGRAMMING.

Vertical integration was at the heart of Congress's concerns. Congress believed that "a few large, vertically integrated firms increasingly control large segments of the domestic cable marketplace."[6] It worried that such firms would "favor programming services in which they have an interest, denying system access to programmers affiliated with rival MSOs and discriminating against rival programming services with regard to price, channel positioning, and promotion."[7] And it was concerned that such discriminatory treatment would "reduce diversity in programming by threatening the viability of rival programming services."[8]

But during the next nine years, while the ownership provisions of the Act and the Commission's initial rules were being appealed, vertical ownership in the cable industry dropped precipitously. In 1992, 48% of all national cable programming services were owned by cable operators. By January 2002, when NCTA filed comments on the First Further Notice, that number had fallen to only 26% – a change that, as Professor (and former FCC Chief Economist) Howard Shelanski noted, "directly reduces the extent to which cable operators could diminish the amount and diversity of programming being offered on the market by discriminating in favor of programming that they own."[9]

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6 Report of the Committee on Energy and Commerce of the House of Representatives, H.R. Rep. No. 92-628, 102d Cong., 2d Sess. 41 (1992) ("House Report").

7 *Id.*

8 *Id.*

9 Statement of Howard A. Shelanksi, attached to NCTA Comments, Jan. 4, 2002 at 9.

In the past three years, vertical integration of programmers and cable operators has diminished even further. According to the Commission's 11th Annual Report on the Status of Competition in the Market for the Delivery of Video Programming, only 23% of cable programming networks were vertically integrated as of 2004. That report documents and graphically portrays the decline in vertical integration:

> As of June 2003, there were approximately 339 nonbroadcast programming networks available for carriage by MVPDs. As of June 2004, there were 388 national nonbroadcast programming networks. Of these networks, cable operators had ownership interests in 89, compared to 110 networks reported in June 2003. Thus, during this period, vertical integration of national programming services between cable operators and programmers has decreased from 33 percent as of June 2003 to 23 percent as of June 2004.[10]

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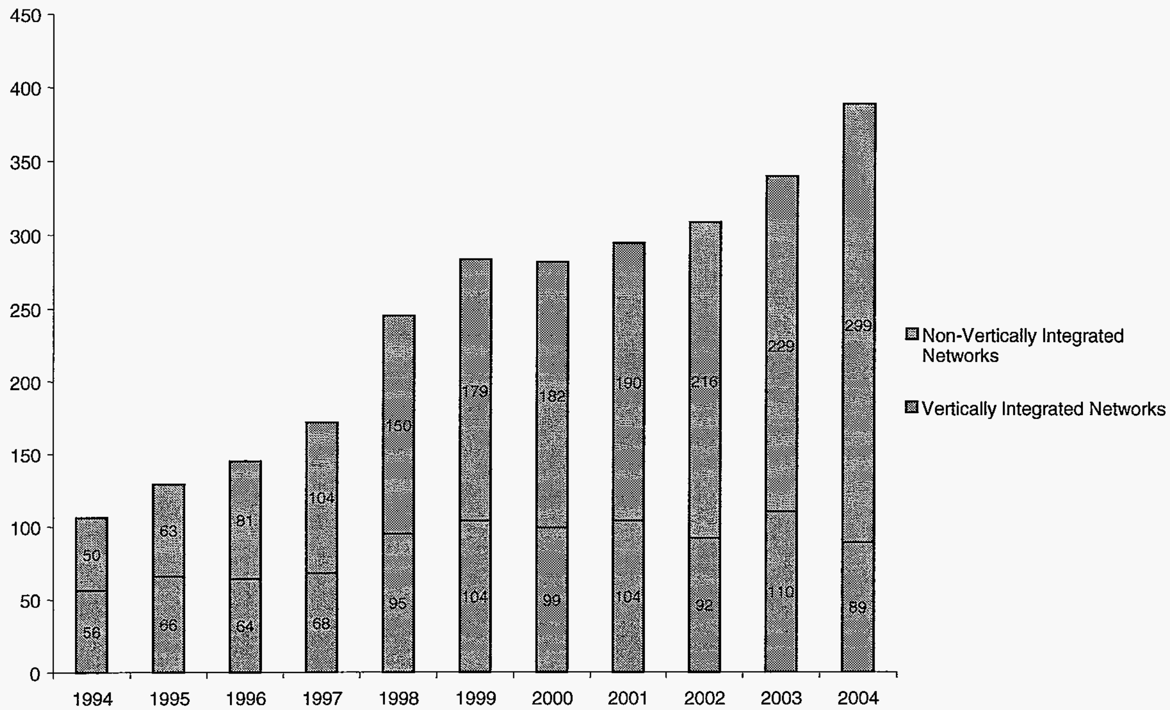
[10] Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, Eleventh Annual Report, 20 FCC Rcd 2755, 2763-64 (2005) ("Eleventh Annual Report"). The Commission went on to note that:

> As of June 2004, four of the top six cable MSOs, ranked by subscribership, held ownership interests in programming services, the same as a year earlier. In addition, we identified 103 national, nonbroadcast networks that are not owned wholly or in part by a cable operator, but are owned by one or more media entities, such as a broadcast television network or broadcast station licensee. Thus, we have identified 196 national nonbroadcast networks, representing approximately 51 percent of the 388 networks, that are not affiliated with either cable or other media entities.

Id. at 2764.

Vertically Integrated and Non-Vertically Integrated Networks



Meanwhile, as the percentage of vertically integrated networks continues to decline, the number of channels available on cable networks has expanded dramatically since 1992. Taken together, the decline in vertical integration, the increase in channel capacity, and the growth of retail competition from alternative providers have essentially mooted Congress's core concern that large cable operators could constrict the flow of diverse programming to consumers by favoring their vertically integrated networks. Cable operators do not, of course, have sufficient capacity to carry every program network that seeks to be carried. But as we said in our comments in 2002, "even if every vertically integrated cable operator were to carry every one of its affiliated program networks, there would be more than enough channels to ensure vibrant competition among vertically integrated and non-integrated program networks from multiple, diverse sources."

The changes that have occurred in the last three years only solidify this conclusion, and the Commission's Eleventh Annual Report confirms that this is the case. It reports that "of the 15 new programming networks that were launched in 2004, two are affiliated with cable operators. In 2003, 39 new networks were launched; four of these networks are affiliated with cable operators. . . ."[11] In other words, any fear that development of unaffiliated programming might be squeezed out by program networks owned by cable operators has turned out to be unwarranted.

II. COMPETITION AT THE RETAIL LEVEL FROM DBS AND OTHERS VITIATES CONCERNS THAT CABLE OPERATORS WILL UNFAIRLY REFUSE TO CARRY OR REDUCE THE SUPPLY OF QUALITY PROGRAMMING THAT ATTRACTS VIEWERS.

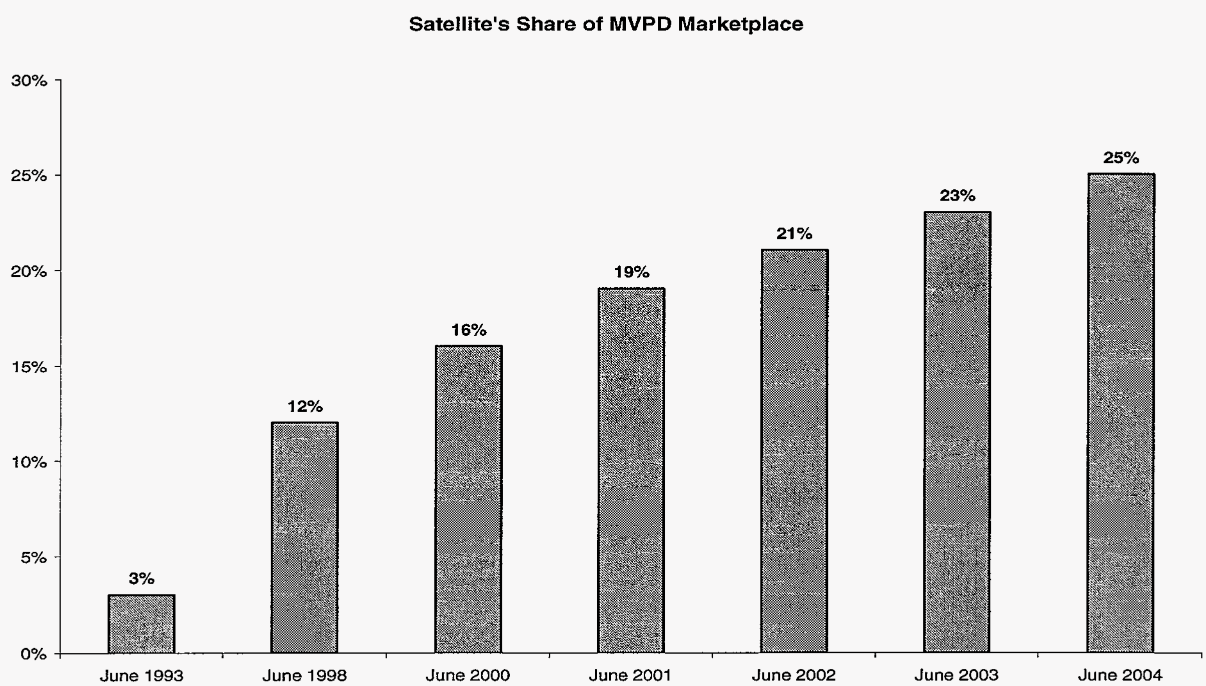
There has been another critically important sea change since Congress mandated ownership caps in 1992. At the time of the 1992 Act, cable operators faced competition from many sources of entertainment, including, for example, broadcast stations, video rental stores, live theater and sporting events, motion pictures, and video games. But they rarely faced competition from alternative multichannel video programming distributors that offered customers similar arrays of nonbroadcast cable program networks.

To say that this has changed would be an understatement. Most prominently, the advent of Direct Broadcast Satellite (DBS) service – which was only just beginning when the ownership provisions were enacted – transformed the marketplace. Today, consumers across the nation have at least three competitive sources of subscription multichannel television services: at least

[11] *Id.*

one cable operator, and two established DBS operators. The Commission's annual reports on the status of video competition have documented the rapid growth of DBS competition and the fully competitive role that DBS now plays.

In its most recent report, the Commission found that "cable subscribership is remaining relatively stable as the MVPD market grows; thus, cable's share of the MVPD market is declining. In contrast, DBS subscribership continues to increase *at nearly double-digit rates of growth, and its share of the marketplace is increasing*."[12]



The Commission also recognized this key fact: While cable still has a substantially larger share of MVPD subscribers than DBS, cable operators face vigorous competition virtually everywhere: "We do not believe that the fact that large numbers of consumers continue to subscribe to cable service indicates a lack of choice." To the contrary, "[t]oday, almost all

12 *Id.*

consumers have the choice between over-the-air broadcast television, a cable service, and at least two DBS providers" and "they are exercising their ability to switch among MVPDs."

The implications of this dramatic change in the competitive landscape were already clear to the Commission when it initiated its rulemaking on remand from the Court of Appeals almost four years ago. As the Commission recognized, "the competitive presence of DBS reduces cable operators' incentive to choose programming for reasons other than quality because a cable operator that selects programming on some other basis risks loss of subscribers if high quality programming is available via DBS."[13] The Court of Appeals also understood the relevance and importance of DBS competition. Thus, as the Commission notes in its Second Further Notice, the court "required that in fashioning another limit, we recognize that market power depends not only on market share but on the '*availability* of competition.'"[14]

While the legislative history of the 1992 Act indicates that Congress was largely concerned with the potential ability of large cable operators to engage in unfair and anticompetitive discrimination against unaffiliated program networks, the Commission and some commenting parties have also raised the prospect that large operators might use "monopsony" power to unfairly suppress the prices that program networks obtain for their programming. But because almost every television household can readily choose from at least three competing multichannel providers, even a provider with a large market share cannot readily refuse to carry a service for reasons other than quality and attractiveness to viewers. And this competition among distributors undercuts a single cable operator's ability to suppress the price it pays for

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[13] Further Notice of Proposed Rulemaking, 16 FCC Rcd 17312, 17326-27 (2001) ("2001 Further Notice").

[14] Second Further Notice, ¶ 24 (quoting *Time Warner II*, 240 F.3d at 1134) (emphasis in original).

programming in a manner that would adversely affect the availability of programming that consumers would want to watch.

As NCTA pointed out in its comments on the 2001 Further Notice, even a cable operator that served the lion's share of MVPD subscribers nationwide would not have incentives to bargain for a price so low as to impair the quality of the programming it offered its customers. As we noted, "[s]uch a cable operator would not have the option of capturing monopoly profits by selling less (or lower quality) programming at monopoly prices because consumers in virtually all of the communities that it served could turn to one of the ubiquitously available DBS providers or another competitor that offered more or higher quality programming and/or lower prices."[15] The ability of such competitors to offer more or higher quality programming in such circumstances has, if anything, been enhanced by the subsequent acquisition of one of the major DBS competitors by a company that is itself a major producer of programming and need not rely on program networks whose quality has been impaired by monopsony pricing.

Moreover, as the Commission acknowledges, a number of parties submitted economic analyses pointing out that the unique characteristics of the cable programming marketplace do not make it susceptible to monopsony abuse. For example, several economists explained, in technical economic terms, that "the supply curve is not upward sloping, and that buyers cannot force the price down by reducing their purchases, because it is costless to supply programming to one more subscriber, if the service is already being provided to other subscribers."[16]

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[15] NCTA Comments at 15, *citing Addamax Corp. v. Open Software Foundation, Inc.*, 888 F. Supp. 274, 280 (D. Mass. 1995), *citing* J. Jacobson & G. Dorman, "Joint Purchasing, Monopsony and Antitrust," *Antitrust Bulletin*, 1, 17 (Spring 1991); Areeda, et al., *Antitrust Law*, ¶ 574.

[16] Second Further Notice, ¶ 86.

Finally, market experience since 2001 demonstrates that, ownership interests aside, cable operators' "investment" in affiliated *and unaffiliated* programming, in the form of licensing fees and other payments, has sharply increased. And the result has been increased audience shares and increased expenditures by programmers.[17]

III. BROADBAND COMPETITION BETWEEN TELCOS AND CABLE OPERATORS FURTHER DIMINISHES THE NEED FOR – AND WOULD BE ADVERSELY AFFECTED BY – CABLE OWNERSHIP LIMITS.

Retail competition from DBS is sufficient to constrain cable operators from discriminating against attractive but unaffiliated program networks in order to favor networks that they own. And provision of cable service by incumbent local exchange companies (ILECs) will only strengthen these competitive constraints. With an abundance of wireline and satellite options, consumers will seek the provider that offers the programming that they prefer. A cable operator that chooses not to carry a service that customers want to watch will risk losing those customers to a competitor that carries the service.

Telco competition, like DBS competition, eliminates the need for ownership restrictions on cable operators because it diminishes the likelihood of discrimination against non-vertically integrated programmers. But ownership restrictions are not only rendered unnecessary by telco competition. Restrictions would also *adversely affect* the vibrant competition between cable operators and telephone companies that is occurring in the broadband provision of video, voice and data services.

In the broadband marketplace, it is both counterproductive and unfair to impose limits specifically on the number of households that are provided with *cable* service. The effect would

[17] Between 2001 and 2004, cable network programming expenditures increased from $10.08 billion to $14.65 billion according to Kagan Research, LLC. During the same time period, viewing of advertising supported cable

be to limit the size – and potential economies of scope and scale – of incumbent cable operators (who currently have the largest number of video customers), while their much larger telco competitors have no such restrictions on their core telephone customers.

While the ownership provisions of the 1992 Act did not anticipate the broadband convergence and competition between cable operators and telephone companies, the Telecommunications Act of 1996 was intended to foster just such competition. Preventing incumbent cable operators from growing in size in order to meet the competitive challenge of ILEC competition would be directly at odds with that objective. It would give telephone companies an unfair advantage in competing for video and Internet customers and in fending off competition in their core business.

IV. "BARGAINING THEORY" AND "OPEN FIELD" APPROACHES ARE INSUFFICIENTLY PRECISE TO JUSTIFY A RIGID OWNERSHIP CAP.

Recognizing that monopsony abuse and favoritism toward vertically integrated programmers may be dead ends as potential justifications for horizontal ownership limits, the Commission resurrects other potential frameworks for attempting to identify anticompetitive abuses associated with high market shares. For example, the Commission discusses "bargaining theory" as a possible basis for establishing an ownership cap.[18]

networks rose from a total day share of 41.1 to 46.5 according to Cabletelevision Advertising Bureau's analysis of Nielsen Data.

[18] As the Commission explains, "Bargaining theory is an alternative framework to the theory of monopsony for analyzing how a large purchaser of programming services could exercise market power and cause harm to the market.... Bargaining theory is often used to model bilateral negotiations, and is usually better able to handle complex market structures, and to take into account transaction-specific factors." Second Further Notice, ¶ 90 (footnote omitted).

The Commission took a tentative step in this direction by commissioning its own "experimental economics" study in the last round of this proceeding. As the Commission notes, that study was roundly criticized and its flaws and shortcomings pointed out by many commenting parties. In its Second Further Notice, the Commission acknowledges the "limitations" of the study but nevertheless continues to "believe that experimental economics can be a useful tool for evaluating the effects of increasing concentration."[19] That may be true, but whether it can ever be a sufficiently reliable basis for a hard and fast ownership limit remains dubious.

The record in this proceeding and the Commission's Second Further Notice make clear the complexity of the experimental economics approach – and, indeed, of any "bargaining theory" approach to identifying a single point at which horizontal ownership is likely to have adverse effects on a competitive programming market. The Commission's discussion not only identifies the range of conflicting theories but also suggests the inherent difficulty of collecting sufficient data to apply such theories empirically with sufficient of precision.

Similar problems seem inherent in the "open field" approach that the Commission used in establishing the 30% limit, which the court rejected. That approach attempts to identify the number of television households that a programming network needs to enter or survive in the marketplace, and to set an ownership cap that prevents any single operator (or multiple operators by colluding) from causing a network to fail simply by refusing to carry it. The court rejected the previous "open field" limit because it was set to ensure that two colluding operators could not block entry. The court found no evidence that such collusion was likely to occur. As NCTA showed in its comments on the 2001 Further Notice, "Not only is there no evidence that any such

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[19] *Id.*, ¶ 104.

collusion among MSOs in the selection of programming has occurred. There is also no reason to believe that MSOs have any incentive to engage in such activity."[20]

But wholly apart from issues of collusion, the "open field" approach is difficult to apply empirically. As the Commission recognizes, what is a "critical mass" of households for one program network may be more or less than what is necessary for others: "Clearly different types of networks need access to different numbers of subscribers."[21] Even if the Commission were to base a limit on the *average* number of subscribers needed by program networks, gathering information to determine that average number with any precision would be very difficult, let alone converting it to an ownership limit that would not be too restrictive to meet the heightened First Amendment scrutiny applied by the court of appeals.

V. THERE IS NO EVIDENCE THAT VERTICAL OWNERSHIP RULES ARE NECESSARY TO PREVENT ANTICOMPETITIVE HARM.

Just as marketplace developments have vitiated the concerns underlying the horizontal ownership provisions of the statute, these developments have also undermined any reasons for limiting the number of channels occupied by vertically integrated program networks. NCTA and cable operators showed in comments on the 2001 Further Notice why this is so.

The decline in the percentage of program networks owned by cable operators (and the much smaller percentage of networks owned by any single cable operator), coupled with system upgrades dramatically increasing the number of programming channels offered by virtually all cable systems, makes it hard to imagine how any cable operator could significantly harm the

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20 NCTA Comments at 19.

21 Second Further Notice, ¶ 76.

competitive flow of programming by favoring networks that it owns. In any event, vigorous nationwide competition from two strong DBS providers, telephone companies, and other multichannel providers constrains cable operators from discriminating against and refusing to carry networks that consumers would want to watch.

As we noted in our previous comments, "[e]ven when the Commission adopted its former rules, at a time when vertical integration was more prevalent, it 'recognized that the need for a vertical limit would likely decrease as channel capacity increased' and operators needed to fill more available channels. The declining percentage of programming services owned by cable operators guarantees that cable operators will need to purchase unaffiliated services to fill their expanded channel capacity."[22] Moreover, as the Commission acknowledges, "[b]oth Congress and the Commission have long recognized that vertical integration produces efficiencies in the production, distribution, and marketing of video programming, enabling cable operators to make additional investments in both distribution plant and programming."[23]

In its Second Further Notice, the Commission concedes that the last round of comments and reply comments provided no basis for concluding that *any* particular vertical limit would be necessary to prevent anticompetitive harm or would be reasonable in light of the countervailing pro-competitive benefits of vertical integration. Nevertheless, the Commission believes it is "bound to follow Congress' statutory directive that a vertical limit be set." Thus, as in the case of the horizontal ownership rules, the Commission has conflicting mandates:

> [T]he challenge in implementing Section 613(f)(1)(B) in light of *Time Warner II* remains one of finding and adequately justifying a reasonable numerical limit that permits cable operators to enjoy the benefits of vertical integration, protects against any potential harms of discrimination against rival programming that may

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[22] NCTA Comments at 21, *citing* 2001 Further Notice, ¶ 75.

[23] Second Further Notice, ¶ 146.

> exist, and takes account of the vastly changed technological and competitive landscape that characterizes today's MVPD marketplace, while not burdening substantially more speech than necessary.[24]

In the absence of any evidence that a vertical cap, at any level, is necessary to prevent anticompetitive harm, no cap would pass muster even under an "arbitrary and capricious" standard, much less the heightened First Amendment scrutiny of *Time Warner II.* And if the 2001 Further Notice elicited no basis to justify a cap, the continued decline in vertical integration and the steady growth of competition in the retail market from DBS, telcos and others since then makes it even less likely that any such evidence exists today.

CONCLUSION

At bottom, the Commission faces the same dilemma today as it faced when it adopted its 2001 Further Notice on remand from the court of appeals. It is directed by statute to adopt limits on horizontal ownership. But it is required by the court's mandate and by the First Amendment to adopt a cap that is crafted to advance the purposes of the statute – a task made exceedingly difficult by the changed circumstances that make unfair foreclosure of programming improbable regardless of an operator's size.

In these circumstances, either the ownership cap should be sufficiently flexible to take into account the unique circumstances and marketplace factors that surround any particular merger or acquisition or it must be sufficiently permissive to ensure that it does not bar innocuous mergers that pose no threat to a competitive programming marketplace. Such flexibility and permissiveness would, in any event, be consistent with the statutory mandate that

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[24] *Id.*, ¶ 147.

any ownership limits "reflect the dynamic nature of the communications marketplace" and not "impair the development of diverse and high quality video programming."[25]

Similarly, there is no evidence that a cap on the number of channels that may be occupied by vertically integrated channels is necessary to prevent anticompetitive harm. To impose such a cap in the absence of such evidence would be arbitrary and capricious and would, as the *Time Warner II* court made clear, be barred by the First Amendment.

Respectfully submitted,

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[25] 47 U.S.C. § 533(f)(2).